Lochiel Exploration Ltd.

1980 Annual Report

Lochiel Exploration Ltd.

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CORPORATE PROFILE

Lochiel Exploration Ltd. is an independent Canadian-owned oil and gas company engaged in exploration and production in western Canada, Ontario and the United States, and with broad exploration interests in the Beaufort Sea, Canadian Arctic Islands and Egypt. The Company also holds a 0.9486 percent interest in the Buchan oil field, located in the U.K. sector of the North Sea, where production is expected to commence in late May of this year.

At January 31, 1981, the Company had 5,899,573 Class A non-voting common shares, 5,784,095 Class B voting common shares and 569,450 9% convertible preferred shares outstanding. Approximately 94 percent of the voting Class B common shares are owned by Canadians.

The Company's shares are listed on the Toronto and Alberta Stock Exchanges.

ANNUAL MEETING

Shareholders are cordially invited to attend the annual meeting to be held at the Royal York Hotel, Toronto on July 6, 1981 at 10:00 a.m.

Comparative Highlights

years ended January 31, 1981 and 1980

	1981	1980	Increase (Decrease) Percent
FINANCIAL			
Total revenue	$ 2,514,000	$ 2,294,000	10
Funds generated from operations	$ 277,000	$ 746,000	(63)
per common share 1980		13.0¢	
per Class A common share 1981	2.6¢		
per Class B common share 1981	2.2¢		
Net income (Loss)	$ (496,000)	$ 251,000	(298)
per common share 1980		4.4¢	
per Class A common share 1981	(8.3¢)		
per Class B common share 1981	(6.9¢)		
Capital expenditures and exploration expenses	$ 5,867,000	$ 8,331,000	(30)
Working capital	$ 769,000	$ (654,000)	218
Long-term debt	$10,092,000	$ 9,721,000	4
Shareholders' equity	$11,188,000	$ 5,926,000	89
Total assets	$24,055,000	$18,701,000	29
Common shares outstanding		5,739,326	
Class A	5,899,573		
Class B	5,784,095		
OPERATIONS			
PRODUCTION — gross before royalties			
Crude oil and natural gas liquids — barrels	28,500	34,000	(16)
Natural gas — MCF	785,000	1,020,000	(23)
LAND			
Working interest — gross acres	3,921,400	1,598,400	145
Working interest — net acres	1,149,899	775,900	48
Gross royalty acres	2,435,242	2,715,700	(10)
DRILLING ACTIVITIES			
Gross wells drilled	63	47	34
Net wells drilled	10.7	12.5	(14)
Net wells productive	7.9	11.0	(28)
Net wells dry	2.8	1.5	87
RESERVES — gross proven and probable			
Crude oil and natural gas liquids — thousands of barrels	1,274	866	105
Natural gas — BCF	28	28	—

MARKET VALUE ON COMMON SHARES

Calendar Year	1st Quarter High	1st Quarter Low	2nd Quarter High	2nd Quarter Low	3rd Quarter High	3rd Quarter Low	4th Quarter High	4th Quarter Low	Share Volume
	$	$	$	$	$	$	$	$	
1977	1.75	1.38	1.68	1.23	2.47	1.42	3.25	2.06	2,562,394
1978	2.38	1.95	3.85	2.19	4.30	2.60	3.50	2.45	4,140,700
1979	4.15	2.90	5.70	3.70	5.50	4.15	7.40	3.50	4,513,248
1980	8.50	4.30	8.25	6.50	9.37	6.62	7.87	6.00	3,306,776

Report to the Shareholders

During 1980 the Company continued its efforts to expand assets through a broadening of activity into areas which represent exceptional potential.

The Company participated in a record 63 drilled wells (10 oil, 45 gas, 8 dry), an increase of 34 percent over 1979.

Western United States

In July the Company opened an office in Denver, Colorado through its wholly owned United States subsidiary, Lochiel Exploration Inc. The Company intends to take advantage of higher oil and gas prices and lower drilling and land costs and royalties available in the United States.

The initial four wells of an eight well exploration program in Kansas have been completed, resulting in two oil wells and two dry holes. Both oil wells commenced production early in 1981. Seismic is being shot before selecting the sites of the remaining four wells of the program and any development wells.

In December, the Company purchased interests in four producing oil wells in Routt County, Colorado which are yielding 60 barrels of oil per day net to Lochiel. The transaction included 10,710 gross acres (5,073 net acres) of land on a trend similar to the producing wells. An independent evaluation estimates the future value of net cash flow of proven developed reserves at $2,391,000 and total expected value including undeveloped properties of U.S. $6,298,000 using a discount factor of 15 percent.

Subsequent to year end, Lochiel Exploration Inc. formed and is operating a $10 million, 60-well joint venture project in Kansas and Oklahoma. To date, 120 potential Prospects have been identified and land acquisition is in progress. Drilling is to commence in June. The Company has about an 18 percent interest in the venture.

Eastern United States

During the year the Company, through its subsidiary Seis-Ex Geophysical Ltd., increased its interest in the Panama Field from 65 percent to 95 percent. Production during the year averaged 400 thousand cubic feet per day.

Seis-Ex participated in the drilling of 36 wells resulting in 33 gas wells and two oil wells. Each of the gas wells contained royalty interests to the Company.

During 1981 Seis-Ex will operate a drilling program with Dome Oils Inc. and Page Petroleum Inc. A seismic program, followed by at least four exploratory wells, is planned. Net cost to Seis-Ex is expected to be $400,000.

United Kingdom

The Buchan Field, in which the Company has a .95 percent interest, will commence production before the end of May. An independent evaluation commissioned by the Company estimates the present value of proven and probable reserves with 15 percent discount factor at U.S. $11,422,000 before taxes. Cash flow net to Lochiel is likely to be U.S. $1,500,000 in 1981 and U.S. $4,000,000 in 1982.

In May of 1980 the Company acquired a 51 percent interest in Halyard Offshore Limited, a private consulting company specializing in advising on offshore oil loading facilities. Halyard sustained a moderate operating loss for the last nine months of the fiscal year.

Egypt

In June the Company obtained a 20 percent interest in two concessions covering 2,116,000 acres. Lochiel will operate the U.S. $37,000,000 exploration program to start after ratification by the Egyptian parliament, expected in early summer. The commitment during the initial year calls for a seismic option of $1,000,000.

Canada — Provincial Lands

The Company participated in the drilling of 22 wells during 1980, resulting in 6 oil wells, 12 gas wells and four dry holes. The value of reserves in Canada, as determined by McDaniel & Associates Consultants Ltd., increased 10 percent to $13,781,000. As the production history of a number of the new wells becomes better established, especially at Atlee-Buffalo, the Company believes additional value will be demonstrated beyond that presently accepted by McDaniel.

Shortly after year end, the Company entered into a five well drilling program in the Whitecourt area of Alberta. One well has been abandoned. The remaining four are being completed as gas wells, with two of these having potential for oil. The net cost to Lochiel for its 25 percent interest in the initial program is expected to be $1,500,000.

The Company is presently preparing a prospectus for the filing of a $6,000,000 1981-82 Canadian drilling fund with Wood Gundy Limited acting as agent. Lochiel will joint venture with the limited partners for 20 percent of exploration and 40 percent of development expenditures. The programs should commence in August of this year with activities concentrated in the provinces of Alberta, Saskatchewan and Ontario.

Frontier Canada

In the fall of 1980, a major Canadian investment house estimated the value to Lochiel of its Beaufort Sea acreage as $256 million or $22 per common share. While no drilling has yet taken place on the 1,724,000 acres in which Lochiel has royalty interests, the Company does believe much of its Beaufort acreage is on trend with present discoveries and proposed drilling sites.

During 1980, the Char G-07 discovery moved the reserves for gas in the Arctic Islands to an estimated 19 trillion cubic feet. An additional six trillion cubic feet of gas reserves are required for commercial production. The 1980-81 winter drilling program indicates a potential major oil discovery at Cisco B-66 and significant oil and gas flows at Maclean I-72 and Skate B-80. Lochiel has working interests in 929,260 acres and royalty interests in a further 292,625 acres. Although no drilling has as yet taken place in these properties, the Company believes the potential to be very high.

In the spring of 1981, the Company announced that it has acquired a four percent interest in a program which calls for the exploration of 343,194 acres on the Banquereau area of the Scotian Shelf. The exploration program will consist of 684 miles of seismic, environmental studies, and the drilling of an exploratory well within a three year period. The area is situated 65 miles from the Sable Island oil and gas field and thirty seven miles from the highly prospective Venture and Citnalta gas discoveries.

Financial and Operating

In June of 1980, the Company completed a rights offer to common shareholders for 9% Cumulative Redeemable Convertible First Preferred Shares, Series A which provided an injection of equity capital in the amount of $5,739,000. The proceeds were used to reduce temporarily the level of bank borrowings.

On December 11, 1980 the reorganization of common share capital was approved by shareholders of the Company. The two for one split of common shares into Class A nonvoting and Class B voting shares was completed in January, 1981. The Company believes this reorganization of capital will give Lochiel additional flexibility with respect to the financing of future acquisitions.

Net revenue during 1980 was $1,796,000 and represents a nine percent increase from the previous year. The higher level of revenues is primarily the result of improved prices for oil and gas in Canada.

Cash flow generated from operations was $277,000 during 1980, a decline from $746,000 a year earlier. The increase in general and administration expenses to support the expanding activity of the Company and the rise in interest expenses reflecting higher interest rates during 1980 largely accounted for the reduced cash flow.

The production from the western United States operations and the commencement of the Buchan Field in May of this year will contribute to dramatic increases in revenues and cash flow for 1981.

Capital expenditures during 1980 declined marginally to $5,806,000, with 33 percent of this amount incurred in Canada, 27 percent in the United States, and 40 percent in the United Kingdom. Capital expenditures for 1981 are forecast to be $6,300,000 including $3,200,000 in Canada, $2,400,000 in the United States and the remaining $700,000 in the United Kingdom.

OUTLOOK FOR THE INDUSTRY

In assessing where an oil and gas company should operate, profitability and stability of political climate have to be two major factors.

In examining profit potential the net-back to the oil company is the all important factor and not what the consumer pays for that oil. The consumer may well pay world prices for oil as they do in England and Norway, yet the net-back to the producer is close to what the producer receives in Alberta where the consumer pays half of so-called "world" or OPEC prices. This is because of different taxes and royalties levied against the oil. We are presently talking about a net-back in Alberta of around $8 or $9 Canadian per barrel compared with about $30 Canadian in the North Sea which scales down to about $5 Canadian after a certain profit has been attained.

Net-backs then are as much, or more, a function of taxing policies as they are of consumer pricing.

The other major factor governing profitability is the cost to the oil company of acquiring and drilling leases. Here we have the great equalizer between competitors in that where the highest net-backs in the world prevail (the United States at U.S. $18 to $20 per barrel), we have high land prices and/or a small amount of acres per prospect. This compares with lower prices per acre and/or more acres per prospect in Saskatchewan where the net-back is only $5 or $6 Canadian per barrel.

It is therefore obvious that a high net-back anywhere in the world attracts capital that quickly raises the price of leases and reduces the amount of acreage acquired per prospect so that profitability soon evens out from area to area and country to country.

It now becomes apparent that political stability and the ability to forecast political moves and subsequent changes in taxation become almost as important as finding oil itself. Since this is impossible to do for even the best of political pundits, the wise oil and gas manager spreads his risks among many political jurisdictions.

This your Company has tried to do, with operations in the North Sea, Mediterranean, United States, Asia and elsewhere.

In assessing the new Canadian National Energy Policy your Company is optimistic in that since over 90 percent of our shareholders are Canadian, and with management controlled blocks such that it is impossible for foreign buying on our exchanges to reduce us below 75 percent, your Company will therefore benefit by the 80 percent grants for frontier wildcats and 35 percent for wildcats in the provinces. These grants should make up for the reduction in cash flow occasioned by the eight percent PGRT (Petroleum and Gas Revenue Tax). In addition, the obvious encouragement for Canadians to expand their ownership in the oil and gas industry should bring in new Canadian investors to partner with our expertise in drilling funds and at the same time pressure the foreign controlled companies that presently own our foreign lease inventories, to farm-out to Canadian companies.

As shown earlier, the "made in Canada" price to the consumer has little relevance to the producer. It is the amount of government revenue extracted that has the major effect on the producer's net-back and therefore profitability. It is quite possible because of the tremendous difference between the net-back to the producers and the "world price" to have a policy where this difference is split among the mineral rights owner (the province in most cases), the federal government, and to the consumer in lower than "world prices", and still have a profitable oil industry.

It is also not unreasonable to expect a country where it is possible to have lower than "world prices" for the food producer and manufacturer to do so, in order to enjoy a bit of competitive advantage in the world market. After all, the Canadian consumer and taxpayer subsidized the Canadian oil industry and provincial governments owning oil and gas rights to a limited extent from 1960 to the present with federal tax incentives, and from 1960 to 1973 by paying higher than "world prices".

DIRECTORS AND SENIOR PERSONNEL

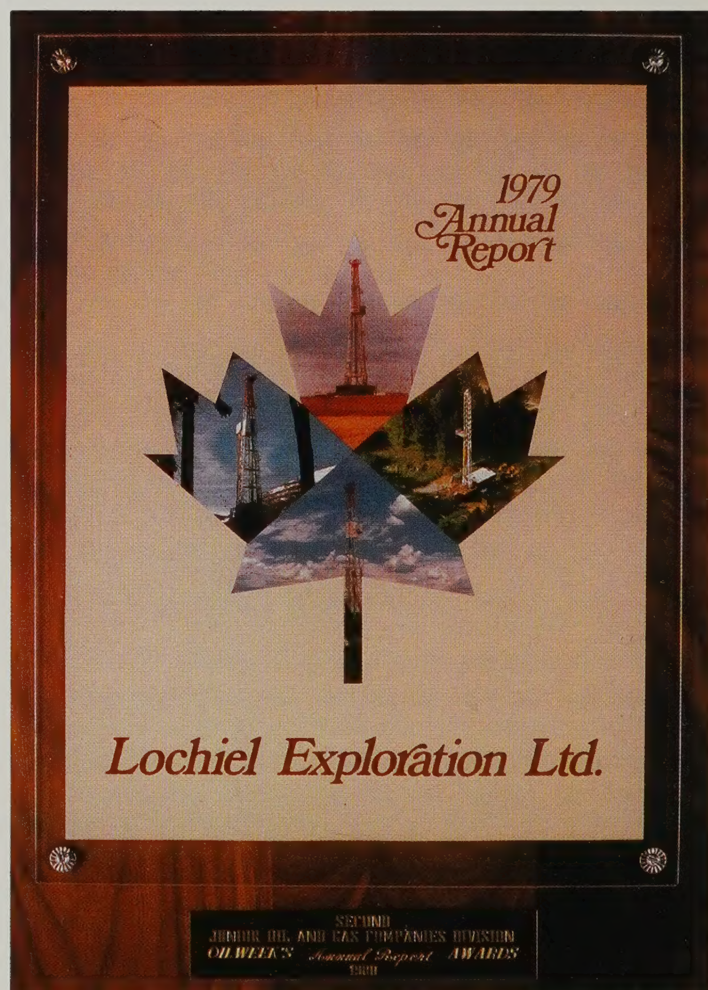
In June of 1980, the Company was pleased to report the election of Mr. S. G. B. Pearson, retired businessman and formerly Senior Vice President of Gulf Canada Limited, and Miss Patrice L. Taylor of the firm Johnson, Liknaitzky & Mariash, Barristers and Solicitors to the Board of Directors.

In April 1981 the Board of Directors accepted with regret the resignation of Mr. A. Mark Turner as Director and Executive Vice President of the Company. His service to the Company will be sorely missed.

Submitted on behalf of the
Board of Directors

Nicholas W. Taylor
President

May 20, 1981
Calgary, Alberta



In October, 1980, Lochiel Exploration Ltd. was honoured by having its 1979 Annual Report judged SECOND BEST in the Junior Oil & Gas Companies Division of the Oilweek Magazine Annual Report Awards Program. The plaque commemorating this award is shown in the photograph above.


NORTHWEST TERRITORIES
ALBERTA
BRITISH COLUMBIA
SASKATCHEWAN
UNITED STATES
AITKEN CREEK
BUICK CREEK
RED CREEK
Dawson Creek
LEGEND LAKE
MINK LAKE
ATHABASCA OIL SANDS
LUBICON LAKE
BOHN LAKE
HOUSE MTN.
MARLBORO
GLENEVIS
SKARO
WHITFORD LAKE
Edmonton
PEMBINA
BRETON
PIGEON LAKE
BAXTER LAKE
WAINWRIGHT
SOUTH ALIX
KESSLER
GARRINGTON
PROVOST
DRUMHELLER
SUNNYNOOK
Calgary
CESSFORD
QUIRK CREEK
SHOULDICE
ATLEE-BUFFALO
CLARESHOLM
TABER
Sixth Meridian
Fifth Meridian
Fourth Meridian
Lochiel Interests
Miles 64 0 64 Miles

Exploration and Development

During the year ending January 31, 1981, Lochiel Exploration Ltd. continued its aggressive exploration and development program, participating in the drilling of 63 wells, a record for the Company. This activity resulted in 45 gas wells, 10 oil wells and eight dry holes. The success ratio of 87 percent reflects the policy of Lochiel to be selective in the choice of drilling prospects.

The 22 wells drilled in western Canada resulted in 12 gas wells and five oil wells. This compares to six gas wells and three oil wells from 19 wells drilled in western Canada during 1979.

In the eastern United States, 36 wells drilled resulted in 33 gas wells and two oil wells. During 1980, the Company expanded its activities into the western United States. The four wells drilled in the latter portion of the year resulted in two oil wells.

1980 DRILLING RESULTS

Total Wells: (Direct and Indirect Participation)

	Working Interest		Royalty Interest
	1980	1979	1980
EXPLORATORY			
Oil	7	9	0
Gas	10	8	4
Dry	7	10	0
DEVELOPMENT			
Oil	2	0	1
Gas	2	0	29
Dry	1	0	0
TOTAL	29	27	34

Geographical Distribution of Drilling

	Oil	Gas	Dry	Total
Alberta	4	12	4	20
British Columbia	0	0	0	0
Saskatchewan	1	0	1	2
United States	4	33	3	40
United Kingdom	1	0	0	1
TOTAL	10	45	8	63

WESTERN CANADA

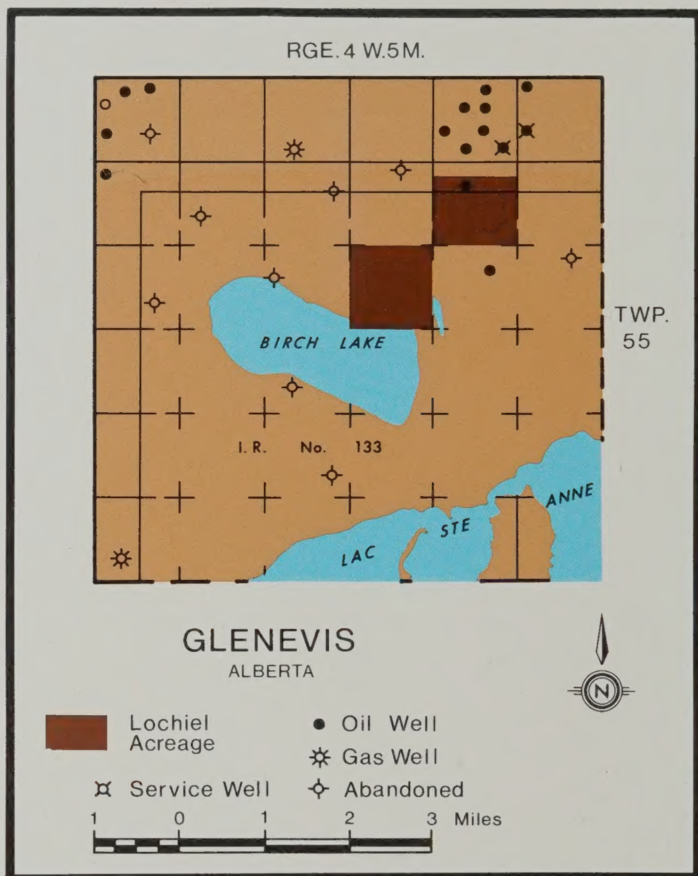
The Company participated in the drilling of 22 wells in western Canada, including 10 wells through the Lochiel 78 Energy Program.

- **Atlee-Buffalo, Alberta**

In 1980, the Company initiated an aggressive drilling program to increase cash flow and maintain gas contract volumes. Seven wells were drilled of which four have been completed as gas wells and one as an oil well. Six gas wells were tied in during the year, including two wells completed in prior years which had been standing shut-in. In the coming year, Lochiel plans to initiate further drilling to evaluate deeper plays.

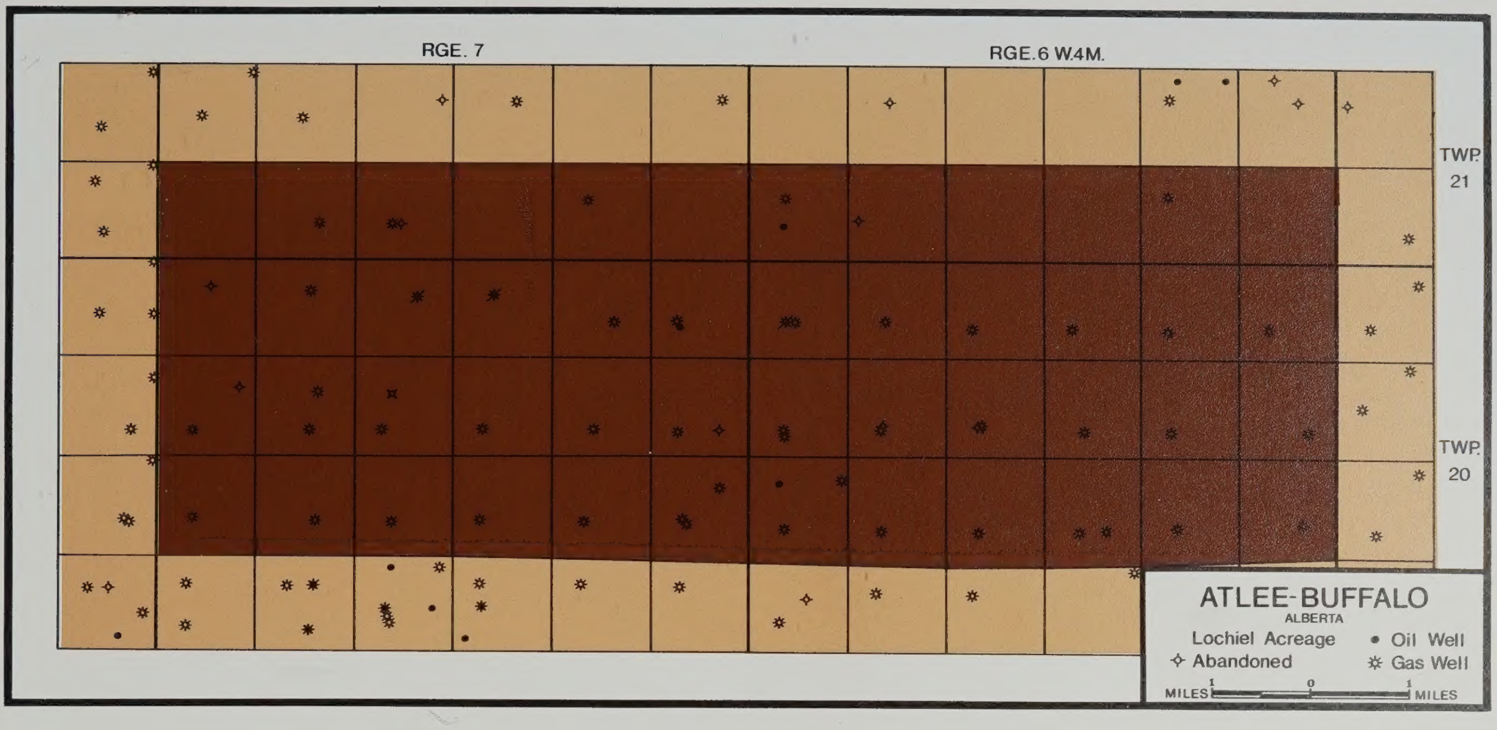
- **Glenevis, Alberta**

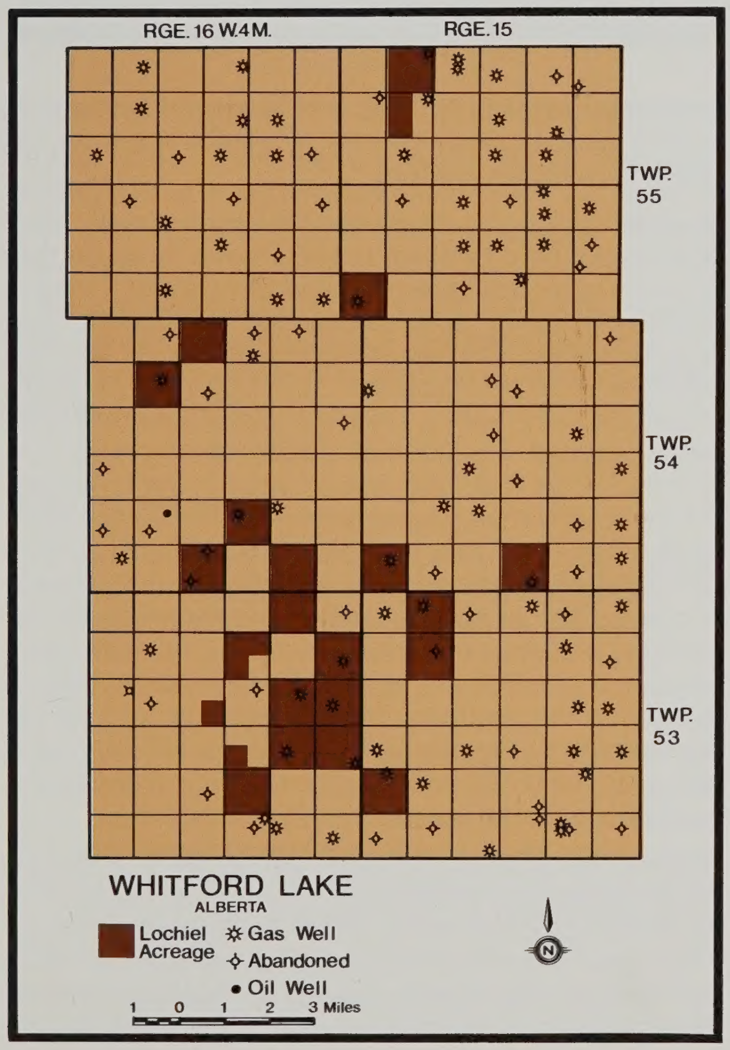
A Mississippian Banff oil prospect, 11-26-55-4W5M was drilled on the Alexis Indian Reserve and is currently producing oil at rates up to 100 barrels per day. Lochiel also participated in acquiring additional lands which are adjacent to the Glenevis oil field which to date has produced in excess of 6 million barrels of oil. A seismic program has been completed and further drilling is expected during 1981. Lochiel has a 12½ percent interest in these programs.



- **Garrington, Alberta**

During the year the Company farmed out its interest in a one-half section parcel of land for an overriding royalty. A well was drilled and cased as a potential gas well. Lochiel has received a large non-refundable cash royalty prepayment.





• Keystone (Pembina), Alberta

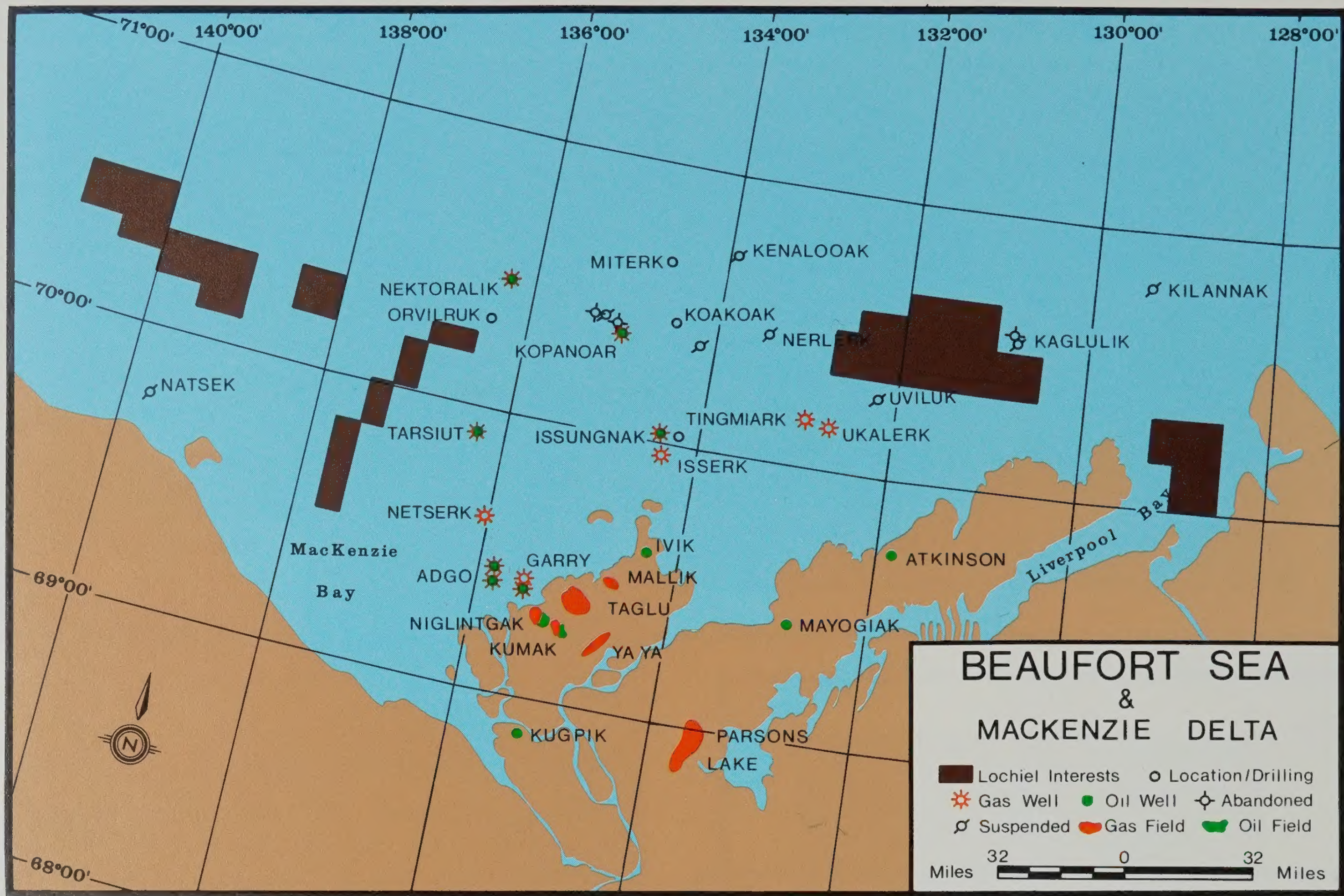
The Company drilled a 6,000 foot Banff test to earn an interest in two sections of land in the Pembina Keystone area. The well has been cased to total depth pending further evaluation as a gas well. An adjoining licence comprising 4,320 acres was purchased and has been farmed out under favorable terms to another operator with a drilling commitment for June, 1981.

• Lochiel 78 Energy Program

Through the Lochiel 78 Energy Program the Company participated in the drilling of 10 additional wells resulting in six gas wells, two oil wells and two dry holes. The undiscounted cash flow of proven and probable reserves per Unit has increased to $153,310 as of March 1981 from $102,790 the previous year.

During the year seven wells were drilled at Whitford Lake, Alberta, resulting in six gas wells and one Viking oil well. Since the inception of the Program 14 wells have been drilled on this Prospect for nine gas wells, one oil well, two dry holes and two suspended wells which failed to flow gas in commercial quantities. The combined gross reserves for the 10 wells are 16,983 million cubic feet of gas and 39,800 barrels of oil. Two gas wells are currently producing and three additional wells will be tied in this summer.

A follow-up well was drilled at Handsworth in southeastern Saskatchewan which resulted in an Alida oil well. Two dry holes were drilled, both in Alberta, at Sunnynook and Alsike.



BEAUFORT SEA

Acreage Held	Interest
686,000 acres	3.000% gross overriding royalty
825,000 acres	1.400% net carried interest 0.567% gross overriding royalty
213,000 acres	0.300% gross overriding royalty

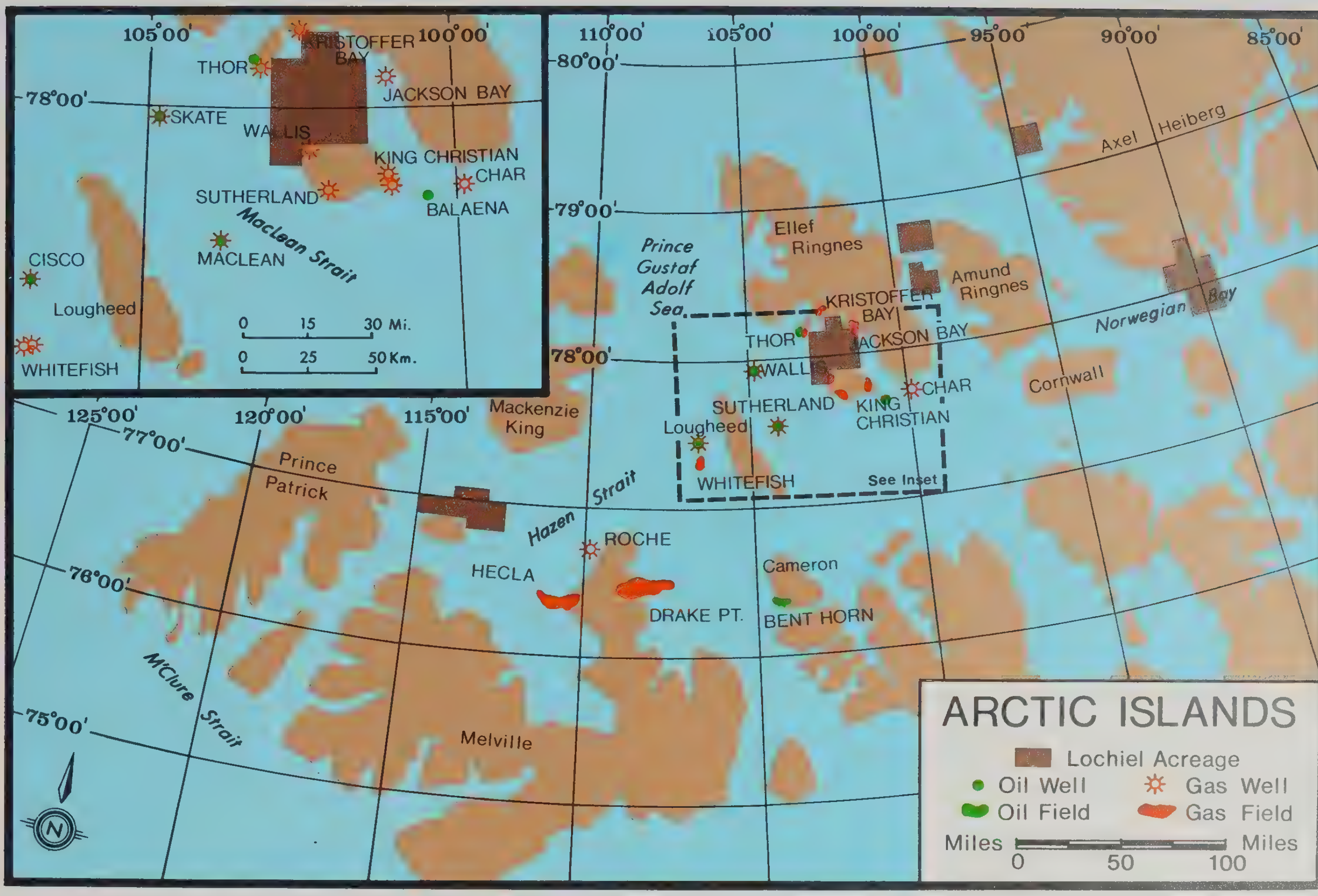
The 1980 Beaufort Sea exploratory drilling program resulted in the confirmation by Dome Petroleum Limited of a discovery drilled in 1978-79 at Tarsiut and the addition of a new gas and oil well by Esso Resources Canada Ltd. at Issungnak.

After being suspended in late 1979, the Dome Tarsiut A-25 well was re-entered in 1980 and subsequently tested a 160-foot sand-shale section at the 4,500-foot level at rates of 3.2 million cubic feet of gas per day and oil at 800 barrels per day with no water.

Esso Issungnak 0-61, which was drilled to a total depth of 11,755 feet on a separate structure 17 miles north of the Isserk E-27 gas discovery, also tested gas and oil. A calculated absolute open flow in excess of 50 million cubic feet of gas per day with condensate was established from a test at 9,700 feet. A second test in a separate reservoir at 9,300 feet produced light gravity sweet oil at a calculated rate of 2,400 barrels per day with no formation water.

Due to severe ice conditions, five other Dome operated wells being drilled in 1980 failed to reach their primary objective before the end of the drilling season. Kopanoar 2I-44 was suspended at 10,400 feet, approximately 400 feet above the prolific oil reservoir discovered in the Kopanoar structure in 1979. Dome Koakoak 0-22, with a planned total depth of 16,000 feet, reached 12,200 feet before drilling was suspended. Core data and electric logs in the lower part of the hole indicated sand reservoirs with hydrocarbon accumulations. The projected 15,000-foot Orvilruk 0-03 well stopped drilling at 11,800 feet after penetrating a section of porous sand immediately above the primary objective horizons. No log or core evaluations were conducted. Dome Kenalooak 2J-94, with a planned total depth of 16,000 feet, reached 11,200 feet and the Kilannak M-76 well drilled 2,300 feet of the planned 10,000-foot test before ice and weather conditions forced suspension of operations.

Before the year-end, Dome had brought a second large dredge into the Beaufort Sea to begin work on an artificial island 3½ miles east of the Tarsiut discovery. The island will be used to establish the commerciality of the oil reservoir and feasibility of installing a permanent production facility through the drilling of several



directional holes into the underlying Tarsiut structure.

During 1981, Dome plans to complete the five wells suspended in 1980 and commence drilling on three new wells. Esso will be drilling another well at Issungnak.

Lochiel Exploration Ltd. has gross over-riding royalty and net carried interests in 1,724,000 acres, much of which is in the vicinity of present and proposed drilling activity.

ARCTIC ISLANDS

Two wells drilled by Panarctic Oils Ltd. in the offshore area east of King Christian Island were completed as multi-zone hydrocarbon discoveries in the spring of 1980. Panarctic AIEG Char G-07 recovered 1,580 feet of oil with no water at a depth of 4,315 feet. A second test at 5,250 feet flowed gas at the rate of 18.1 million cubic feet per day with a small amount of condensate. The Panarctic AIEG Balaena D-58 well produced small quantities of medium to heavy crude oil and no formation water from a test at 1,345 feet while a second zone at 5,480 feet flowed gas at 3 million cubic feet per day with a small amount of oil through a restricted choke.

The 1980-81 winter drilling season of Panarctic has proven to be highly successful with the discovery of the first potentially large reserves of oil in the Sverdrup Basin.

Three wells drilled from ice platforms off Lougheed Island encountered multi-pay hydrocarbon bearing zones of major significance. Panarctic AIEG Skate A-80, northeast of the island, tested gas at 5.6 million cubic feet per day with 775 barrels of oil per day at a depth of 2,900 feet and gas at 7.3 million cubic feet per day from another zone at 5,100 feet. Tests conducted in the Panarctic MacLean I-72 well, 26 miles southeast of Skate A-80, resulted in flow rates of gas at 5.8 million cubic feet per day and 9.7 million cubic feet per day with 1,673 feet of oil from two separate reservoirs at 4,850 and 5,800 feet respectively. The Panarctic AIEG Cisco B-66 well, located west of Lougheed Island, also tested two separate horizons. The upper zone at 5,400 feet flowed oil at 1,465 barrels per day plus 1.08 million cubic feet of gas per day with the lower section at 6,900 feet producing oil at 1,691 barrels per day and gas at 6.9 million cubic feet per day.

Lochiel's property north of King Christian Island is strategically located on trend with hydrocarbon discoveries immediately adjacent to the permit area and within 25 miles of the major oil discoveries off Lougheed Island. Although no drilling has as yet been undertaken on these lands, the potential for this acreage is very high.

ONTARIO

During the past year the Company has acquired in excess of 12,000 acres in Oxford County. In 1981 the Company plans to drill several wells on this newly acquired acreage and several wells in Kent County. An offset to the gas discoveries of Shell Canada at Ashfield in Huron County and a development well in offshore Lake Erie in the Dover Field may also be drilled this year.

EASTERN UNITED STATES

The Company's operations in the northeastern United States are through a wholly owned subsidiary, Seis-Ex Geophysical Ltd., which has an office in Lakewood, New York.

In Chautauqua County, New York, Seis-Ex increased its interest in the Panama Field from 65 percent to 95 percent. Production from the field averaged 400 thousand cubic feet per day during 1980. In the Kiantone area, Seis-Ex drilled three wells resulting in one oil well, one suspended gas well and one dry hole.

In the Clymer area, the operator of the farmout program drilled 19 wells, resulting in 18 Medina gas wells and one Devonian oil well. Connection to the gas pipeline has not yet been completed, but it is anticipated that all wells will be on production later in 1981. Seis-Ex has a royalty interest in these wells. Further drilling is expected in 1981.

In the Sugar Grove area of Warren County, Pennsylvania, 14 Medina gas wells were drilled through two farmouts in which Seis-Ex has a royalty interest. One well is producing and four others will be placed on production shortly. Nine more wells will be drilled in 1981 under these farmouts.

At North East in Erie County, Pennsylvania, 22 gas wells were placed on production in 1980 from a farmout, and two more are awaiting hook-up. Seis-Ex has a royalty on this production.

In Chautauqua County, four more areas have been farmed out with terms calling for the drilling of 24 wells to test the Medina within the next year. Seis-Ex has retained a royalty interest in these wells.

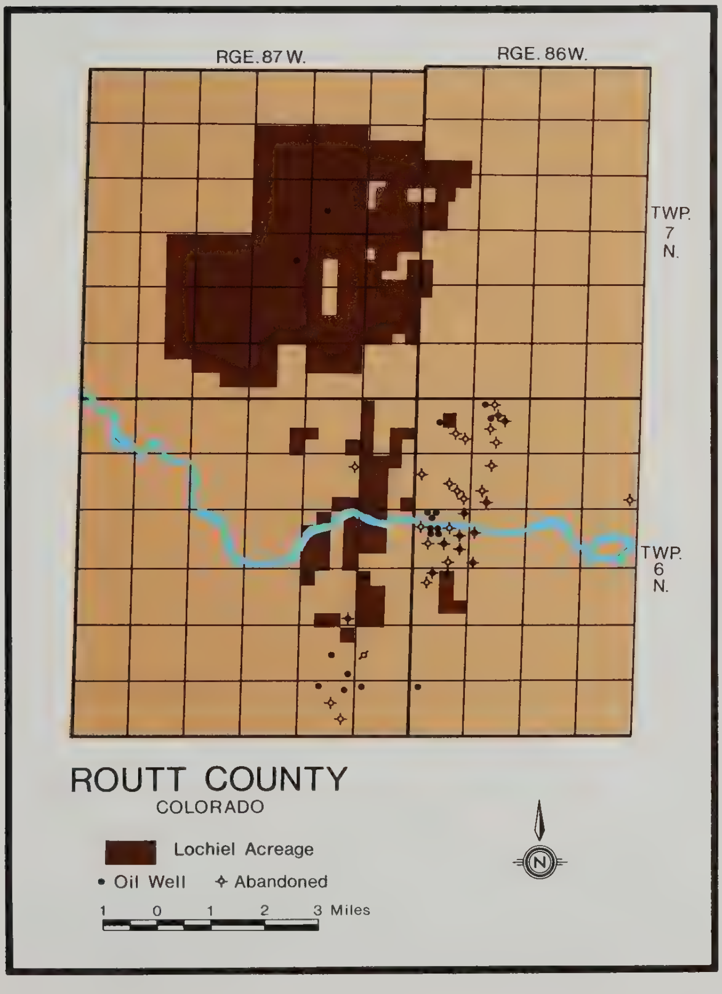
In partnership with Dome Oils Inc. and Page Petroleum Inc., Seis-Ex will be conducting an exploration program in the Appalachian Basin area in New York and Pennsylvania. At least four exploratory wells are planned during 1981, and a seismic program will be carried out in areas where it is known that Devonian reefs are developed.

WESTERN UNITED STATES

Through its wholly owned subsidiary, Lochiel Exploration Inc., the Company established an office in Denver, Colorado in July of 1980. Two projects have commenced to date, with exploration efforts concentrated within the state of Kansas.

In the latter portion of 1980, Lochiel entered into a farmout agreement whereby it would participate in the drilling of eight exploratory wells in Ness, Sheridan and Trego Counties. Four wells have been drilled resulting in two oil discoveries. Gross combined production from the two wells averages 15 barrels per day. A seismic program has been shot to assist in selecting the remaining exploratory and resultant development locations. The Company has a 25 percent interest in this program.

The Company has also purchased in December 1980 interests in four producing oil wells in Routt County, Colorado which are yielding 60 barrels per day net to Lochiel. The transaction included 10,710 gross acres (5,073 net acres) of land on a trend similar to the producing wells. A photogeological study is presently being conducted and additional land acquired in the area. A development drilling program is planned for later in 1981 or early 1982.



Early in 1981, the Company acquired a number of partners to participate in a $10,000,000, 60 well joint venture project in south central Kansas. Drilling is expected to commence in late May or early June of this year. Lochiel is the operator of the project and expects to retain an 18 percent working interest.

EGYPT

Lochiel Exploration Ltd. announced in late June, 1980 that an agreement had been reached between the Egyptian General Petroleum Corporation and a Calgary based group represented by Lochiel Exploration Ltd., Page Petroleum Ltd., and Polar Bear International Ltd. whereby the group will explore for oil and gas on two concessions in Egypt. The terms of the agreement call for expenditures of U.S. $37,000,000 which are to be made over five and one half (5.5) years. Lochiel has been designated as Operator for the project.

The project area to be explored, covering a total of 2,116,000 acres or approximately 8,560 square kilometres, includes the Sheiba concession, south of the large El Alamein oil field, and the Ras-El-Hekma concession located offshore west of Alexandria.

Lochiel is currently evaluating the available seismic data in the project area, and expects to begin additional seismic work after the evaluation of the existing data is completed.

Subsequent to year end a second Calgary based group represented by Lochiel and Page is negotiating with the Egyptian General Petroleum Corporation for the rights to explore an additional concession. This concession, located near the Sheiba concession in the Western Desert, contains approximately 5,000 square kilometres and will require expenditures in excess of $20,000,000 over about a six (6) year exploration period. If the negotiations are successful Lochiel will be designated the Operator in the concession agreement.

UNITED KINGDOM

The Buchan Field lies 96 miles north and east off the coast of Aberdeen, Scotland. It is situated 9,850 feet below the seabed, in a water depth of 400 feet. It is estimated that Block 21/1 comprises almost 90 percent of the Buchan Field, with a small extension into Block 20/5. The Field was discovered in August 1974 and consent for development was granted by the Department of Energy in March 1978.

Seven development wells in addition to the discovery well have been successfully completed. The production facility involves the connection of these wells, with subsea completion, to the floating production platform from where the crude will be pumped to a mooring buoy and transported ashore by tanker.

The floating oil-production platform, Buchan "A", was installed in the Buchan Field in late September 1980. Considerable work required completion on-site, the major items associated with the handling systems for the oil production and export risers. Immediately before riser running trials were due to commence during December, a threaded plug blew out of a high pressure air vessel after the system had been hydrostatically tested. For reasons of safety, the entire associated systems had to be examined and reworked.

In mid-January, when preparations were again being made for the riser running trials, divers found that the subsea manifold had been damaged, possibly during an extreme storm that had been experienced immediately beforehand. The damaged parts of the structure have had to be replaced. The subsea work has now been substantially completed and riser trials were commenced in the latter part of March.

The work on production facilities is now 99 percent complete. Oil production from the Buchan Field is scheduled to commence before the end of May of this year.

During October 1980, an agreement was finalized whereby the Texaco Block 20/5 was unitized into the B.P. group, of which Lochiel is a member, and which holds the licence on Block 21/1. The unitization reduces the interest of Lochiel from one percent to .95 percent. However, Texaco's step-out well was tested in April at 9,931 barrels of oil per day. This well, which will be included in the unit, is expected to enhance the size and extent of the oil pool.

The daily production from the Buchan Field is expected to average close to 50,000 barrels (500 barrels per day net to Lochiel). The reservoir has been estimated by independent consulting engineers to contain approximately 50,000,000 barrels of proven and probable recoverable reserves and another 50,000,000 barrels of possible reserves.

BAKER LAKE — MINERAL CLAIMS

An extensive $2,200,000 exploration program consisting largely of diamond drilling was conducted on the group's claims during 1980. Although sufficient tonnages for a viable mineral deposit were not defined, several new surface showings were discovered and encouraging grades and widths of uranium mineralization were encountered in several drill holes. The work program resulted in a better understanding of the regional geology and the nature of the mineralization. This information will serve as a basis for the 1981 program directed primarily to the definition of drill targets for an extensive 1982 drill program. The proposed program for 1981 will consist of surface geology and geophysics and is expected to cost in excess of $800,000. Lochiel has an 8.6 percent working interest in 424,914 acres (36,543 net acres) in the project area.

Land Holdings

As of January 31, 1981, Lochiel holds working interests in 1,149,899 net acres, an increase from 775,895 net acres held the previous year. The major land acquisition during 1980 was a 20 percent interest in two concessions in Egypt.

In addition to working interest acreage, the Company holds royalty interests in 2,435,242 acres, most of which is located in the frontier areas of Canada. The decrease from 2,715,696 royalty acreage in 1979 is due to the expiry of permits and leases in the Yukon and Northwest Territories.

PETROLEUM AND NATURAL GAS RIGHTS

as of January 31, 1981

Working Interest Properties

Geographic Area	Gross Acres	Net Acres
Alberta	164,640	54,604
British Columbia	13,092	1,596
Saskatchewan	15,106	13,809
Ontario	72,000	23,425
Arctic Islands	929,260	538,676
Baker Lake, N.W.T. (Mining Claims)	288,000	24,768
TOTAL CANADA	1,482,098	656,878
United States	122,290	65,573
Italy	92,655	3,706
U.K. (North Sea)	108,400	542
Egypt	2,116,000	423,200
TOTAL FOREIGN	2,439,345	493,021
TOTAL	3,921,443	1,149,899

Royalty Interest Properties

Geographic Area	Gross Royalty Acreage
Alberta	47,200
Arctic Islands	292,625
Beaufort Sea/MacKenzie Delta	1,723,880
Eastcoast Offshore	122,851
Pacific Offshore	243,386
TOTAL CANADA	2,429,942
United States	5,300
TOTAL FOREIGN	5,300
TOTAL	2,435,242

Reserves

The Company's gross recoverable reserves as presented in the table below are calculated before deducting Crown and freehold royalties. The Domestic Canadian reserves were determined by McDaniel Consultants (1965) Ltd. as of January 1, 1981. During the year a total of 5,380 million cubic feet was moved from proven to probable category. These reserves will be reclassified when production from Atlee-Buffalo is accelerated by infill-drilling.

The interests of Lochiel in the Lochiel 78 Energy Program were evaluated by M & D Petroleum Consultants Ltd. in March, 1981. The reserves in Routt County, Colorado were evaluated by Martin Petroleum Consulting Ltd. as of May 1, 1981. The reserves in Eastern U.S. were determined by M.T.A. Engineering in November, 1979 and those in the United Kingdom by Gaffney Cline and Associates Ltd. in May, 1978, and updated by Martin Petroleum Consulting Ltd. in May, 1981. Proven reserves have not been assigned to any of the properties in which Lochiel holds overriding royalties.

PROVEN AND PROBABLE RESERVES, 1981

	Proven		Probable		
	Natural Gas (mmscf)	Oil (Barrels)	Natural Gas (mmscf)	Oil (Barrels)	Total Barrel Equivalents*
Canadian	13,520	203,000	8,431	140,000	4,001,000
Lochiel 78 Energy Program	1,243	71,000	—	17,000	295,000
United States	3,215	410,000	2,000	—	1,279,000
United Kingdom	—	267,000	—	166,000	433,000
TOTAL	17,978	951,000	10,431	323,000	6,008,000

* Conversion ratio to determine equivalents; 1 barrel = 6 mcf natural gas = (barrel liquid).

Production

Natural Gas

During the past fiscal year the Company's sale of natural gas, before royalties, was 785 million cubic feet, a decrease of 23 percent from the previous year. This production decrease was primarily due to nil gas requested for a period of 3½ months under the take or pay contract and also low nomination for the remainder of the year at Atlee Buffalo Sandstone Unit #1, the major gas producing property of the Company.

Crude Oil

In Canada the Company produces the majority of its oil from five areas: House Mountain, Baxter Lake, Wainwright and Garrington in Alberta and Virden Roselea in Manitoba. Domestic oil production decreased by sixteen percent to 28,500 bbls.

On December 31, 1980 Lochiel acquired an interest in 4 producing wells in Routt County, Colorado. Lochiel is the operator of two of these wells. Lochiel's share of production from Routt Couty is estimated at 20,000 bbls per year before royalties and taxes.

Production Platform for Buchan Field

Routt County, Colorado

Financial Review

OPERATING REVIEW

Despite the shut-in during the year of Atlee-Buffalo in Alberta for three months and the Panama Field in New York State for two months, total revenue for 1980 increased by 9.6 percent to $2,514,000 from $2,294,000 the previous year.

A net loss of $496,000 was incurred which compares to net income in 1979 of $251,000. Cash flow in 1980 was $277,000, 63 percent lower than the same figure a year earlier.

Total expenses before income taxes increased to $2,406,000 from $1,422,000 in 1979. The increase of operating expenses was primarily due to the inclusion of Halyard expenses for nine months and Seis-Ex expenses for the full fiscal year. Revenues of Halyard are not oil and gas sales but rather included in other income. As the result operating expenses rose sharply to $673,000 in 1980 from $348,000 in 1979.

The overall expansion of the Company's international activities, including the opening of offices in Denver and Cairo, and the expansion of the London, England facilities, resulted in a 60 percent increase of general and administrative expenses to $438,000 in 1980.

The absolute level of debt in 1980 remained at a level similar to the prior year, though much higher interest rates starting in March contributed to the increased interest expense of $571,000 in 1980 from $445,000 in 1979.

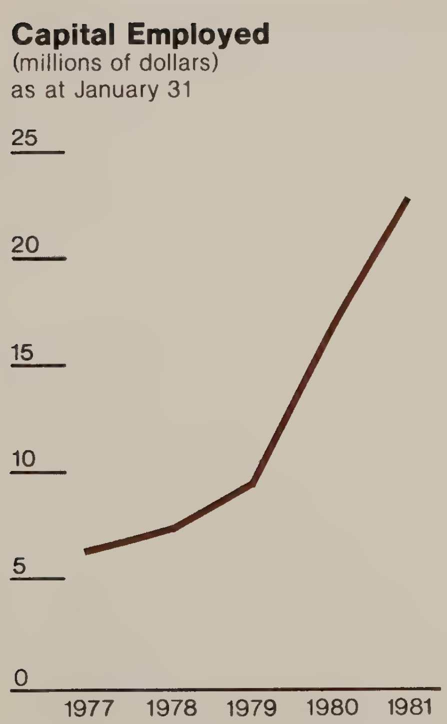
The higher level of depletion and depreciation expense in 1980 over 1979 was due to a 25 percent increase in the resource cost base and the reclassification of certain gas reserves in Canada from proven to probable.

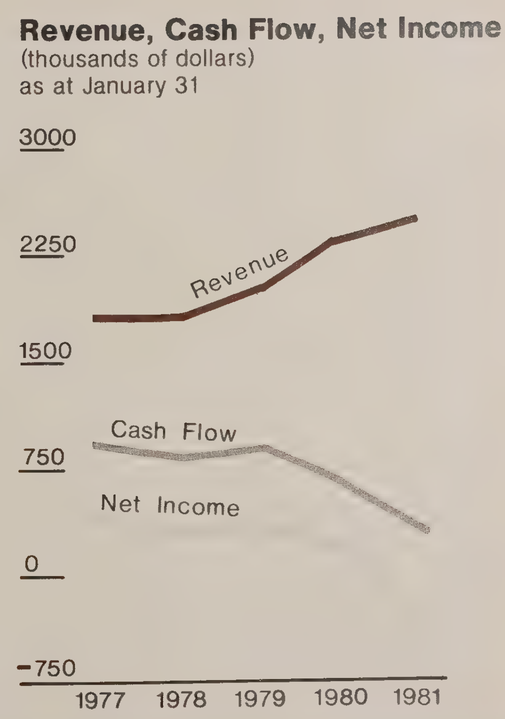
FINANCIAL POSITION

Capital expenditures in oil and gas properties declined marginally to $5,806,000 in 1980 from $5,991,000 a year earlier. 33 percent of the expenditures were incurred in Canada, 40 percent in the United Kingdom for the further development of the Buchan Field project, 11 percent in the Eastern United States, and 16 percent in the Western United States.

In May of 1980, the Company successfully completed a rights offering for 9% Cummulative Redeemable Convertible Preferred Shares, Series A, with par value of $10 per share. The net proceeds of $5,514,160 were applied as a temporary reduction of bank production loans, which were reborrowed later in the year to finance the capital expenditures.

In January of 1981, the Company reorganized the common share structure, creating separate Class A non-voting and Class B voting shares through a two for one split of the common shares to holders of record January 9, 1981. A two percent stock dividend was declared on Class A shares concurrent with the share split. This capital restructuring will provide greater flexibility for future financing should the need arise.





AUDITORS' REPORT

The Shareholders
Lochiel Exploration Ltd.

We have examined the consolidated balance sheet of Lochiel Exploration Ltd. as at January 31, 1981 and the consolidated statements of loss, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at January 31, 1981 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
May 1, 1981

Touche Ross & Co.
Chartered Accountants

CONSOLIDATED STATEMENT OF LOSS

FOR THE YEAR ENDED JANUARY 31, 1981

	1981	1980
REVENUE		
Oil and gas sales	$2,452,501	$2,253,999
Less royalties and mineral taxes	656,877	605,405
Net sales	1,795,624	1,648,594
Other income	61,140	40,305
	1,856,764	1,688,899
EXPENSES		
Operating	672,992	347,970
Interest on long-term debt (Note 5)	571,114	445,411
General and administrative	438,055	273,878
Amortization	29,452	—
Depletion and depreciation	694,627	354,930
	2,406,240	1,422,189
Income (loss) before income taxes	(549,476)	266,710
INCOME TAXES		
Current — Provincial royalty tax credit	(102,299)	(124,283)
Deferred	48,362	140,452
	(53,937)	16,169
Net income (loss) for the year	$ (495,539)	$ 250,541
Net income (loss) per share (Note 11)		
1980 — common shares		4.4¢
1981 — class "A" common shares	(8.3¢)	
— class "B" common shares	(6.9¢)	

CONSOLIDATED STATEMENT OF DEFICIT

FOR THE YEAR ENDED JANUARY 31, 1981

	1981	1980
RETAINED EARNINGS AT BEGINNING OF YEAR	$ 412,310	$ 161,769
Net income (loss) for the year	(495,539)	250,541
Dividends paid on preferred shares	(215,112)	—
RETAINED EARNINGS (DEFICIT) AT END OF YEAR	$ (298,341)	$ 412,310

Lochiel Exploration Ltd.

and Subsidiary Companies

CONSOLIDATED BALANCE SHEET

AS AT JANUARY 31, 1981

	1981	1980
ASSETS		
CURRENT ASSETS		
Cash	$ 307,123	$ —
Accounts receivable	973,934	720,289
Provincial royalty tax credit	348,835	246,536
Prepaid expenses	10,288	24,420
	1,640,180	991,245
INVESTMENTS AND LONG-TERM RECEIVABLES (Note 3)	1,628,807	1,209,390
PROPERTY, PLANT AND EQUIPMENT, AT COST		
Oil and gas properties	21,633,802	17,293,205
Production equipment	1,498,340	1,151,049
Other	109,069	56,868
	23,241,211	18,501,122
Less accumulated depletion and depreciation	2,699,526	2,000,777
	20,541,685	16,500,345
OTHER ASSETS		
Financing costs, net of amortization	208,427	—
Excess of purchase cost of subsidiary over net assets acquired	35,640	—
	244,067	—
	$24,054,739	$18,700,980

Signed on behalf of the Board

, Director

, Director

	1981	1980
LIABILITIES		
CURRENT LIABILITIES		
Bank indebtedness, secured	$ —	$ 1,152,526
Accounts payable and accrued liabilities	871,423	492,284
	871,423	1,644,810
DEFERRED REVENUE		
Deferred gas contract (Note 6)	489,357	246,900
Deferred royalty	200,000	—
	689,357	246,900
LONG-TERM DEBT (Note 7)	10,091,610	9,720,805
DEFERRED INCOME TAXES	1,214,250	1,161,995
TOTAL LIABILITIES	12,866,640	12,774,510
SHAREHOLDERS' EQUITY		
Share capital (Notes 8 and 9)		
Authorized		
1,000,000 preferred shares with a par value of $10 each, issuable in series		
10,000,000 class "A" common non-voting shares without par value		
10,000,000 class "B" common voting shares without par value		
Issued		
1980		
5,739,326 common shares	—	5,514,160
1981		
569,450 series "A" preferred shares	5,694,500	—
5,899,573 class "A" common shares	2,895,970	—
5,784,095 class "B" common shares	2,895,970	—
	11,486,440	5,514,160
Retained earnings (deficit)	(298,341)	412,310
	11,188,099	5,926,470
	$24,054,739	$18,700,980

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED JANUARY 31, 1981

	1981	1980
SOURCE OF FUNDS		
From operations		
Net income (loss) for the year	$ (495,539)	$ 250,541
Add items not requiring current outlay of funds		
Depletion and depreciation	694,627	354,930
Amortization	29,452	—
Deferred income taxes	48,362	140,452
FUNDS FROM OPERATIONS	276,902	745,923
Proceeds from sale of oil and gas interests	1,093,281	—
Increase in long-term debt, net	370,805	7,149,805
Increase in deferred revenue	442,457	90,820
Issue of shares (Notes 8 and 9)		
Series "A" preferred shares	5,694,500	—
Common Shares	277,780	—
	8,155,725	7,986,548
USE OF FUNDS		
Property, plant and equipment	5,806,320	5,991,279
Increase in investments and long-term receivables	419,417	577,614
Purchase of subsidiaries (Note 2)	60,965	2,340,014
Dividends paid on preferred shares	215,112	—
Financing costs	231,589	—
	6,733,403	8,908,907
INCREASE (DECREASE) IN WORKING CAPITAL	1,422,322	(922,359)
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF YEAR	(653,565)	268,794
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ 768,757	$ (653,565)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

JANUARY 31, 1981

1. Summary of Significant Accounting Policies

(a) Principles of consolidation
The consolidated financial statements include the accounts of the Company and all its subsidiaries and its proportionate share of a drilling fund, collectively termed "the Company".

(b) Translation of foreign currencies
Balances stated in other currencies have been translated into Canadian funds on the following basis:

(i) current assets and liabilities at year-end exchange rate;

(ii) non-current assets and liabilities at the rate of exchange prevailing at date of transaction;

(iii) revenue and expense at average rate of exchange during the year, except for depreciation and depletion which are on the same basis as the related asset.

Unrealized exchange gains or losses are deferred and included as part of accounts payable.

(c) Joint ventures
The Company conducts substantially all of its oil and gas exploration and production activities on a joint venture basis and the accounts reflect only the Company's proportionate interest in such activities.

(d) Exploration and development costs
The Company follows the full cost method of accounting. Under this concept, all costs relating to the exploration for and the development of oil and gas reserves, including related overhead costs, are capitalized. In addition, interest costs of financing major projects are also capitalized prior to commencement of operations. Proceeds from disposal of properties are normally deducted from costs without recognition of gain or loss.

Separate cost centres have been established for Canada, Frontier Canada, United States, and United Kingdom and other foreign areas.

(e) Depletion and depreciation
Depletion of exploration and development costs and depreciation of production equipment is computed by cost centre using the unit of production method based on the estimated proven oil and gas reserves in each cost centre. Costs related to the Canadian frontier area are carried in a separate cost centre and amortization is deferred pending the outcome in these areas.

(f) Amortization
Financing costs incurred in connection with a preferred share issue are being amortized over a period of ten years. The excess of purchase cost of subsidiary over net assets acquired is being amortized over a period of five years.

(g) Deferred income taxes
The Company follows the tax allocation method of accounting under which the income tax provision is based on the income reported in the accounts. Under this method, the Company provides for deferred income taxes to the extent that income taxes otherwise payable are eliminated by claiming capital cost allowances and exploration and development costs in excess of the depreciation and depletion provisions recorded in the accounts.

2. Acquisition of Subsidiary

(a) Halyard Offshore Ltd.
Effective May 1, 1980, the Company purchased a 51% interest in the voting shares of Halyard Offshore Ltd., a private consulting company involved in the oil and gas industry. Under various agreements and terms the Company has options to purchase the remaining 49% minority interest.

This acquisition has been accounted for as a purchase and the accounts have been consolidated since the date of purchase. The excess of the purchase price of $60,965 over the net book value of assets acquired of $5,972 has been assigned to specific assets to the amount of $8,468 with the balance of $46,525 being amortized over a five year period.

Had Halyard been acquired February 1, 1980, the beginning of the fiscal year of the Company, the accompanying statement of loss would not have differed significantly.

(b) Seis-Ex Geophysical Ltd.
On July 1, 1979 the Company purchased Seis-Ex Geophysical Ltd. for $1,934,066. At the time of purchase Seis-Ex had a working capital deficiency of $405,948.

3. Investments and Long-Term Receivables

	1981	1980
Advances to Lochiel 78 Energy Program — interest at bank prime rate plus 1%	$1,097,756	$ 739,026
Investment and advances — Petromines Limited	425,071	359,663
Investment in shares of other companies	20,056	712
Notes receivable from employees, at cost	60,274	79,759
Refundable deposits, at cost	25,650	30,230
	$1,628,807	$1,209,390

The Company holds 942,281 shares (approximately 26%) of the issued capital of Petromines Limited, of which 413,281 shares are subject to an escrow agreement. These shares have been recorded at cost less a valuation allowance of $182,027.

4. Segmented Information

The Company operates principally in four geographic locations, the identifiable segment assets and exploration and development expenditures of which are as set out below:

	1981		1980	
	Assets	Exploration and Development Expenditures	Assets	Exploration and Development Expenditures
Canada	$11,150,426	$1,928,327	$ 8,658,482	$2,211,980
Frontier Canada	810,176	—	810,176	55,429
United States	4,323,853	1,557,669	3,978,185	1,448,941
United Kingdom and Other Foreign	7,770,284	2,320,324	5,254,137	2,274,929
Totals	$24,054,739	$5,806,320	$18,700,980	$5,991,279

The Company derives all its revenue from oil and gas production and related activities, the amounts of which are earned in the following geographic locations:

	1981		1980	
	Revenue	Profit (loss)	Revenue	Profit (loss)
Canada	$1,478,300	$ 8,883	$1,603,201	$279,897
Frontier Canada	—	—	—	—
United States	330,302	(470,516)	85,698	(29,356)
United Kingdom and Other Foreign	48,162	(33,906)	—	—
Totals	$1,856,764	$(495,539)	$1,688,899	$250,541

5. Capitalized Interest

In accordance with the Company's full cost policy, interest in the amount of $805,863 (1980 — $305,128) has been capitalized as part of the development costs of the Company's Buchan Field (located in U.K. sector of the North Sea). It is anticipated that this project will commence operations in 1981.

6. Deferred Gas Contract Revenue

The Company has a "take or pay" gas purchase contract with TransCanada PipeLines Limited under which TransCanada is obligated to take a determined minimum quantity of gas during a contract year. Failing to take the minimum quantity requires TransCanada to pay the Company at current prices for gas not taken with the right to take delivery of such gas paid for, but not taken, any time within the next ten years. Such gas can only be taken in quantities which exceed the minimum contract quantities of any contract year. The value of the gas not taken at January 31, 1981 amounted to $489,357 and it is anticipated that TransCanada will not take delivery of such gas in 1981.

7. Long-Term Debt

	1981	1980
Production loans, interest payable at Cdn. prime rate plus .75 to 1.25% per annum	$ 4,542,000	$2,964,250
Production loan, interest payable at London, England deposit market rate plus 2% per annum (U.S. $2,804,982)	3,460,450	2,536,690
Production loan, interest payable at U.S. prime rate plus 1½% per annum	—	1,905,705
7% Unsecured Convertible Debentures due July 31,1989 with interest payable semi-annually (U.S. $1,600,000)	1,864,160	1,864,160
7% Subordinated Redeemable Convertible Debentures due August 1, 1989 with interest payable quarterly	225,000	450,000
	$10,091,610	$9,720,805

(a) No portion of the bank production loans has been classified as being payable within one year as these loans are repayable out of future production proceeds and accordingly are not expected to require the use of existing working capital.

(b) The long-term debt is secured as follows:

(i) Production loan (Cdn. prime plus 1.25%) — promissory notes and assignment of book debts and by certain oil and gas properties.

(ii) Production loan (London rate plus 2%) — mortgage over the Company's interest in the Buchan Field in the North Sea and a charge on the shares of a subsidiary company.

(iii) 7% Subordinated Redeemable Convertible Debentures — floating charge on the assets of the Company.

(c) The 7% Unsecured Convertible Debentures are redeemable at $400,000 per year commencing no later than July 31, 1986 or at the Company's option in whole at any time after July 31, 1984. The debenture holders have the option of converting the principal amount outstanding into common shares at any time prior to July 31, 1984 on the basis of 1.02 class "A" and 1 class "B" common shares for every U.S. $5.50 of principal amount outstanding.

(d) The 7% Subordinated Redeemable Convertible Debentures are redeemable at $90,000 per year commencing August 1, 1985 or at the Company's option in whole or in part at any time after August 1, 1981. The debenture holders have the option of converting the principal amount outstanding into common shares at any time prior to July 31, 1985 on the basis of 155 class "A" and 155 class "B" common shares for every $1,000 of principal amount outstanding.

(e) If long-term debt payable in United States funds were translated at the exchange rate in effect at the end of the year, long-term debt would not have changed significantly.

8. Preferred Shares

By a Special Shareholders' Meeting dated March 11, 1980 the capital structure of the Company was altered to provide for the creation of 1,000,000 preferred shares issuable in series with rights and conditions to be determined by the directors of the Company.

A rights offer was subsequently issued to common shareholders of the Company entitling common shareholders to subscribe for a total of 573,932 9% Cumulative Redeemable Convertible First Preferred shares Series "A" with a par value of $10 per share. Each issued share under the offer is convertible by the holder into 1.57 class "A" and 1.54 class "B" common shares up to April 1, 1985 and into 1.20 class "A" and 1 class "B" common shares thereafter up to April 1, 1990.

The changes in the issued shares are as follows:

	Number of shares	Amount
Issued under rights offer	**573,932**	$5,739,320
Converted to common shares	**(4,482)**	(44,820)
Balance January 31, 1981	**569,450**	$5,694,500

During the year dividends in the amount of $215,112 were declared and paid.

9. Common Shares

(a) Reorganization

By Special Shareholders' Resolution dated December 11, 1980 the authorized common share capital of the Company was reorganized from 10,000,000 no par value common shares into 10,000,000 non-voting class "A" common shares without nominal or par value and 10,000,000 voting class "B" common shares without nominal or par value. On January 9, 1981 the 5,783,969 outstanding common shares were divided into 5,783,969 issued class "A" common shares and 5,783,969 issued class "B" common shares.

Under the resolution, the class "A" common shares are entitled to receive dividends in amounts at least exceeding 20% of the value of dividends paid on the class "B" common shares.

(b) Dividends

On December 11, 1980 the Board of Directors declared a 2% stock dividend (class "A" common shares without a deemed value) to all class "A" common shareholders.

(c) Issued shares

	Number of shares	Price per share	Amount
Common Shares			
Balance — January 31, 1980	5,739,326	—	$5,514,160
Share options exercised	3,000	2.75	8,250
7% debentures converted	34,875	6.45	225,000
Predecessor shares exchanged	10	—	—
9% preferred shares converted	6,758	6.46	43,715
Balance — January 9, 1981	5,783,969		$5,791,125

On January 9, 1981, the above 5,783,969 common shares were divided into class "A" and class "B" common shares and the following transactions occurred:

	Number of shares	Price per share	Amount
Class "A" common shares			
Issued on reorganization (above)	5,783,969	—	$2,895,563
9% preferred shares converted	126	3.23	407
Stock dividend	115,478	—	—
Balance — January 31, 1981	5,899,573		$2,895,970

Class "B" common shares			
Issued on reorganization (above)	5,783,969	—	$2,895,562
9% preferred shares converted	126	3.23	408
Balance — January 31, 1981	5,784,095		$2,895,970

(d) Shares reserved

Under share option and debenture agreements the Company has reserved for issuance a total of 1,409,668 class "A" common and 1,382,711 class "B" common shares.

Officers and employees hold options to purchase a total of 183,600 class "A" and 180,000 class "B" common shares of the Company for prices ranging from $1.08 to $1.88 per share which are exercisable from time to time over a four year period ending in 1984.

10. Remuneration of Officers and Directors

The aggregate direct remuneration paid to directors and senior officers (including the five highest paid employees) of the Company was $281,208 for the year. The Company had seven directors during the year and four officers, two of whom were also directors.

11. Net Income (Loss) Per Share

Net income (loss) per share for 1981 has been calculated using the weighted average number of shares outstanding during the period for each of the class "A" and class "B" common shares and taking into account the minimum dividend priorities attached to each class of shares, irrespective of the extent to which dividends may actually have been declared. Class "A" common shareholders are entitled to receive at least 1.2 times the amount of dividends paid to class "B" common shareholders.

12. Commitments

The Company has in the ordinary course of business indeterminable amounts of guarantees and commitments relating to joint venture agreements.

Lochiel Exploration Ltd.

and Subsidiary Companies

FIVE YEAR STATISTICAL REVIEW

AT JANUARY 31
(thousands of dollars, except per share amounts)

	1981	1980	1979	1978	1977
FINANCIAL					
Income Statement					
Oil & gas sales	$ 2,453	$2,254	$1,835	$1,796	$1,806
Royalties paid	657	605	527	590	537
Net sales	1,796	1,649	1,308	1,206	1,269
Interest & other income	61	40	175	6	3
	1,857	1,689	1,483	1,212	1,272
Production expenses	673	348	411	260	201
General & administrative	438	274	156	183	139
Interest expense	571	445	118	89	123
Provincial royalty tax credit	(102)	(124)	(123)	(133)	(122)
	1,580	943	562	399	341
FUNDS GENERATED from operations	277	746	921	812	931
Per common share		13.0¢	16.0¢	14.2¢	16.0¢
Per Class A common share	2.6¢				
Per Class B common share	2.2¢				
Depreciation & depletion	695	355	212	247	289
Deferred income taxes	48	140	242	218	234
Other non-cash items	29	—	—	—	(63)
	772	495	454	465	460
NET INCOME (loss)	$ (496)	$ 251	$ 467	$ 347	$ 471
Per common share		4.4¢	8.1¢	6.1¢	8.1¢
Per Class A common share	(8.3¢)				
Per Class B common share	(6.9¢)				
Balance Sheet					
Working capital	$ 769	$ (654)	$ 269	$ 434	$ 429
Property & equipment (net)	20,542	16,500	8,517	6,405	5,367
Investment & long-term receivables	1,629	1,209	616	540	523
Capital Employed	22,940	17,055	9,402	7,379	6,319
Long-term debt	10,092	9,721	2,571	1,413	1,025
Deferred income taxes	1,214	1,162	999	757	539
Deferred revenue	689	247	156	—	—
Long term liabilities	11,995	11,130	3,726	2,170	1,564
Share capital	11,486	5,514	5,514	5,514	5,407
Retained earnings	(298)	412	162	(305)	(652)
Shareholders' Equity	$11,188	$5,926	$5,676	$5,209	$4,755
COMMON SHARES OUTSTANDING					
Common shares		5,739,326	5,739,326	5,739,326	5,679,326
Class A	5,899,573				
Class B	5,784,095				

	1981	1980	1979	1978	1977
CHANGES IN FINANCIAL POSITION					
SOURCE OF FUNDS					
Funds generated for operations	$ 277	$ 746	$ 921	$ 812	$ 930
Increase in production loans	371	7,150	1,658	909	514
Decrease in investments and long-term receivables	—	175	51	4	188
Deferred revenue	442	91	156	—	—
Issue of shares	5,972	—	—	107	18
Sale of properties	1,093	—	—	—	—
	$8,156	$8,162	$2,786	$1,832	$1,650
USES OF FUNDS					
Property, plant and equipment	5,867	8,331	2,324	1,286	697
Repayment of production loans	—	—	500	394	395
Increase in investments and long-term receivables	419	753	127	21	33
Reduction of prepaid production revenue	—	—	—	126	74
Cancellation of shares	—	—	—	—	209
Dividends	215	—	—	—	—
Financing costs	232	—	—	—	—
	$6,733	$9,084	$2,951	$1,827	$1,408
WORKING CAPITAL increase (decrease)	$1,422	$ (922)	$ (165)	$ 5	$ 242
OPERATIONS					
Production					
(gross before royalties)					
Crude oil & natural gas liquids — barrels	28,500	34,000	26,000	28,000	33,000
Natural gas — MCF	785,000	1,020,000	890,000	1,150,000	1,455,000
Land					
Working interest — gross acres	3,921,400	1,598,400	1,838,900	1,939,800	2,958,400
Working interest — net acres	1,149,899	775,900	1,157,000	1,226,100	2,090,300
Royalty — gross acres	2,435,242	2,715,700	3,510,200	3,510,200	3,510,200
Drilling Activity					
Gross well drilled	63	47	32	18	6
Net wells drilled	10.7	12.5	8	4	3
Net wells productive	7.9	11.0	6	2	2
Net wells dry	2.8	1.5	2	2	1
Reserves					
Crude oil & natural gas liquids — barrels	1,274,000	866,000	1,310,000	1,306,000	545,000
Natural gas — BCF	28	28	24	22	15
Employees — at year-end	21	12	8	6	6

Left to right: Terry Ottoson — Geologist; Ray Chow — Manager of Accounting; Peter Kneeland — Treasurer/Corporate Secretary; Nick Taylor — President; Sheldon Crewson — Vice President, Exploration; Kam Fard — Manager, Production; Rick Smith — Manager, Land; John Horning — Divisional Geologist; Bill Montgomery — Chief Engineer.

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Manager — Production

Raymond K. T. Chow,
Manager — Accounting

Frederick J. Smith,
Manager — Land

Grant Auchincloss,
General Manager Seis-Ex Geophysical Ltd.

Brian Hall,
General Manager Lochiel Exploration (U.K.) Limited

Harold W. Price,
General Manager Lochiel Exploration Inc.

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209, 430 - 16th Street
Denver, Colorado 80202

United Kingdom Office
Halyard Offshore Limited
6 Queen Street, Mayfair,
London W1X 7PH

SUBSIDIARIES AND AFFILIATES

Lochiel Exploration (U.K.) Limited	— 100%
Lochiel Exploration Inc.	— 100%
Lochiel Oil & Gas Limited	— 100%
Seis-Ex Geophysical Ltd.	— 100%
Halyard Offshore Limited	— 51%
Petromines Limited	— 26%

REGISTRARS AND TRANSFER AGENTS
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Calgary, Alberta and Toronto, Ontario

BANKING
The Toronto-Dominion Bank,
Calgary, Alberta
Morgan Grenfell and Co. Limited
London, England

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Calgary, Alberta

SOLICITORS
Major Caron & Company
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Crane & Hawkins
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Crowley Haugley Hansen Toole & Dietrich
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Alberta Stock Exchange

Lochiel Exploration Ltd.

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